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SUBJECT: CUTTING IT CLOSE: GOVERNMENT LIKELY TO MEET 2009 AND 2010 BUDGET TARGETS, BUT BARELY

¶1. (SBU) Summary: State Secretary Tamas Katona told analysts on September 11 that the Finance Ministry is determined to meet its 3.8 percent budget deficit target for 2009. Despite shortfalls in tax revenues, Katona believes that strict control of expenditures, hiring freezes, and other cost saving measures would be sufficient to offset shortfalls. On September 11, Finance Minister Peter Oszko submitted the draft 2010 budget to Parliament. It includes further expenditure cuts of HUF 448 billion (USD 2.4 billion). The 2010 budget is one of the final major elements of the Bajnai government's crisis management plan, and following its expected passage at the end of November, MPs will likely begin turning their full attention to next year's national elections. End summary.

FIGHTING TO MEET TARGETS

¶2. (U) To help mitigate the effects of the deeper than expected economic downturn, the GOH, in consultation with the EU and IMF, increased its 2009 budget deficit target from 2.8 percent of GDP to 3.9 percent in May. During the first eight months of the year, however, the budget deficit already reached approximately 3.5 percent of GDP (HUF 913.5 billion or USD 4.9 billion). The Finance Ministry projects that VAT, corporate tax, and personal tax receipts will be nearly HUF 156 billion (USD 834 million) lower than expected. The Social Insurance Fund deficit is also projected to be nearly HUF 150 billion (USD 800 million) larger than expected. The overall deficit for 2009 is projected at HUF 991 billion (USD 5.3 billion), equivalent to approximately 3.9 percent of GDP.

¶3. (U) The GOH is undertaking a number of measures to ensure the budget deficit does not exceed the 3.9 percent target, including closer scrutiny of ministry spending, instituting a hiring freeze, and enacting other cost-saving measures. For example, the Finance Ministry created a system whereby it assigns Finance Ministry officials to other ministries to report unreasonable spending over HUF 10 million (USD 50,000). The Finance Ministry is also banning spending of prior year residual funds.

¶4. (U) Other announced austerity measures include: suspending the supplementary pension increase in November (about HUF 20 billion/USD 107 million) to offset pensioners price increases; obliging state owned companies to transfer their dividends (HUF 20 billion) to the government; and, freezing HUF 11 billion (USD 59 million) of the general reserve.

TIGHTENING CONTINUES IN 2010

¶5. (U) On September 11, Finance Minister Peter Oszko submitted a tight budget for 2010 based on a deficit target of 3.8 percent, which assumes negative growth of 0.9 percent for 2010. The budget represents a decrease in expenditures by HUF 448 billion (USD 2.4 billion) compared to 2009. This includes preliminarily announced cuts of HUF 40 billion (USD 214 million) for public transport, HUF 125 billion (USD 668 million) for local governments, and HUF 140 billion (USD 749 million)for central budget organizations. Other

measures include reductions in pensions (HUF 80 billion/USD 428 million), housing (HUF 48 billion/USD 257 million), and energy price subsidies (HUF 55 billion/USD 294 million).

¶6. (U) In Oszko's view, the draft budget would not only meet deficit targets, but would also provide stimulus for growth, as balance would be achieved through savings rather than increasing revenues. He also told analysts that increased investor interest is a sign that confidence in Hungary is increasing. (Note: In the September 9 government bond auction, the bid/cover ratio was 4.33, well above August auction ratios of around 1.7. End note).

ANALYSTS CAUTIOUS: RISKS TO BUDGET REMAIN

¶7. (SBU) Analysts are cautious regarding the 2009 budget target, and questioned whether corporate and VAT revenues would meet the target. In addition, Prime Minister Economic Advisor Joseph Szuper and other experts note several risks to the 2010 budget targets, including pressure from MPs to restore planned cuts to local governments, and the possibility that state-invested companies (like the Hungarian railway company MAV) could need state assistance should they run into further trouble.

¶8. (SBU) The IMF, in its latest assessment in early September, however, noted continued improvement in the outlook for Hungary, and observed that the GOH has implemented sufficient structural reforms to decrease GOH spending and promote sustainable growth. In a recent report, JP Morgan noted Hungary could be the next Central European country to adopt the Euro, as it has the best chance of reducing its budget deficit to the required level within a reasonable period.

¶9. (SBU) The main opposition FIDESZ Party has criticized the budget for not going far enough to stimulate growth. FIDESZ party leader Viktor Orban called the 2010 budget "the most dangerous budget of the past 20 years," and has publicly vowed to eliminate the Bajnai government-instituted property tax and roll-back cuts to family subsidies. Most analysts believe that, if elected, FIDESZ will make symbolic changes to the budget, but Hungary's macroeconomic situation gives it little manuvering room to increase spending.

COMMENT:
¶10. (SBU) Based on recent statements by Socialist Party and Free Democratic Party officials in support of the 2010 budget, we expect it to pass without considerable difficulty by the government's target date of November 30. Once this final major piece of the government's economic crisis response program is complete, we expect that most MPs after November will shift their focus to next year's national elections.

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